BRIEF IN SUPPORT OF PETITION.

Jurisdiction Invoked Jurisdiction to review the order of the Seventh Circuit is invoked under section 240 (a) of the Judicial Code as Amended by the act of February 13, 1925 (43 Stat. 1938, 28 U. S. C. A., sec. 47). The order sought to be reviewed became final on December 8, 1941, by the denial of the petition for rehearing (R. 60).

Opinion Below The opinion of the Seventh Circuit appears in the printed record (pp. 55-58). It repudiated decisions holding that the liability of an unregistered stockholder in a bank is *alternative* with that of the registered owner (under the doctrine of the liability of an undisclosed principal), but held that the liability is *joint and several* on the theory that the relationship is that of trustee and *cestui que trust.* It, therefore, concluded that the judgment against the registered owner and the retention of the judgment did not prevent the entry of the second judgment against the petitioner (123 F. (2) p. 503).

Statement of the Case The District Court decided the issues on the pleadings and on the admissions of facts by the answers to the interrogatories. None of the facts are in dispute. The Court made findings of facts which show that the respondent became a creditor of the bank on June 29, 1932 (R. 41). The petitioner transferred his stock to Edith Levinson and she became the registered owner *prior* to June 29, 1932 (R. 42). Respondent recovered

a judgment against the registered owner on May 1, 1937 (R. 42) in the amount of $2,400.00. It ascertained that petitioner was the secret owner of the same stock on December 13, 1938 (R. 43). No steps were taken to either procure the vacation of the judgment or to have it released and to sue the petitioner, but on April 9, 1940, an amendment to the complaint was filed seeking a second judgment against the petitioner (R. 42). The District Court held that the judgment against the registered owner did not prevent a second judgment against the undisclosed owner and that it was equitable to allow interest against the petitioner from May 1, 1937, the date when the first judgment was entered against the registered owner (R. 44). The Seventh Circuit affirmed this decision (123 F. (2) 503; R. 55-58).

ARGUMENT.

I.

The Decision in the Instant Case That the Liability of an Undisclosed Bank Stockholder Is Joint and Several With the Liability of the Registered Owner Is in Conflict With Decisions from Other Circuits Which Hold That the Liability Is an Alternative One.

If the theory of the liability of the unregistered bank stockholder is founded on *agency,* it will have to be conceded by the respondent that its judgment was improperly entered. It is only on the theory that the relationship of the unregistered bank stockholder with that of the registered owner consists of trustee and *cestui que trust* and that the liability is joint and several that the judgment may be sustained. Petitioner cited many decisions supporting his position, *that the liability is founded on the agency theory,* that it is an *alternative* liability, and that *a judgment against one operates as a discharge against the other.* The case of *Hospelhorn* v. *Poe,* decided by the Maryland Supreme Court was cited, among other cases, adopting such view. The opinion in the instant case *repudiated* the doctrine of the Maryland court. It said (R. 57):

> "The appellant has cited and relies upon *Hospelhorn* v. *Poe,* 174 Md. 242, 118 A. L. R. 682. This case holds that the relation of the undisclosed principal and agent exists between parties where one holds in his name the bank stock of another and that in this relationship, the liability is not joint and several but alternative, and that before judg-

ment, where the principal and agent are sued together, an election must be had as to whom the judgment is to be taken against, and if a judgment has been taken against one, it is a bar to suit against the other.

"The liability of the stockholder does not attach and is not worked out through any relation of principal and agent, but it attaches by force of the statute to one who is the stockholder. *Gahagan* v. *Whitney,* 359 Ill. 419, 194 N. E. 581."

It also said:

"The Maryland case rests upon the relationship of undisclosed principal and agent. The *Ericson* case decided by this court relies upon *Chapman* v. *Pettus,* 269 S. W. 268 (Texas Civ. Ap., 1925), in which the Texas Court finds the relationship to be one of trustee and *cestui que* trust, and in this relationship finds it possible to work out the liabilities between the parties equitably, and at the same time save the creditors of the bank from the period of electing the person they shall pursue.

"We think the relationship is more accurately designated as trustee and *cestui que* trust, which enables the Court to reach the very satisfactory and equitable result reached in *Ericson* v. *Slomer,* 94 F. (2d), 437. We are satisfied with the law there laid down, and reaffirm it."

In repudiating the decision of the Maryland court and in basing its decision on the Texas case, the Seventh Circuit *completely misconceived the basic principles* which are discussed in the above cases, and that the Texas and Maryland decisions are *both in accord that the foundation of the liability is the agency theory* and not the trust doctrine.

(1) The Texas Case Recognized the Doctrine of Undisclosed Principal As the Basis for the Liability.

In the Texas case (269 S. W. 268) the wife of the record owner, her husband, *defended* the action against her on the ground that she was the Trustee for her husband and as such Trustee she was not liable. *The trust relationship was established by the evidence.* The Court held that the liability was *not founded on any trust relationship* but, on the contrary, *it was founded on the relationship of agent and principal.* It said (on page 270):

> "But that general rule is no more settled than the specific rules that any person who holds himself out as the owner of shares, by allowing himself to appear as the registered owner on the books of the bank, may be treated as a stockholder; **that one holding stock for an undisclosed principal may be held liable as a stockholder, although in fact he is only an agent;** that although **a trustee, as such,** is **not liable,** yet when stock appears unincumbered in his name, **he is liable.** 1 Cook on Corp. §253; 7 *C. J.,* pp. 769, 770, §§608, 609; *Rankin* v. *Fidelity Ins. Trust & Safe Deposit Co.,* 189 U. S. 242, 23 S. Ct. 553, 47 L. Ed. 792; *Finn* v. *Brown,* 142 U. S. 56, 12 S. Ct. 136, 35 L. Ed. 936; *Kenyon* v. *Fowler,* 215 U. S. 593, 30 S. Ct. 409, 54 L. Ed. 341; *Kerr* v. *Urie,* 86 Md. 72, 37 A. 789, 38 L. R. A. 119, 63 Am. St. Rep. 493." (Emphasis ours.)

It is true that the Texas court used the term "trustee and *cestui que trust*", but this was because in that case the relationship of trustee and *cestui que trust* was established by the evidence in a dispute between the registered owner and the real owner. However, the liability was not founded on the doctrine of trust and *cestui que trust* but on the *doctrine of agency.*

(2) The Decision Is Squarely in Conflict With the Decision of the First and Sixth Circuits.

The leading case on this subject is *Hubbell* v. *Houghton,* 86 Fed. 547, affirmed by the First Circuit in 91 Fed. 453. In that case the *cestui que trust* defended the action on the trust theory. The Court held that the stockholders' liability is based *on the agency theory* and *not* on the trust theory. It also held that if the liability be founded on the trust doctrine *then there must be an expressed* or *active trust* and *not an implied one.* The Court said (p. 552):

> "In looking at the merits of the question before us, we are urged by the defendant to determine that the relations between the registered owners of this stock and the defendant are those of trustees and *cestui que trust,* and that, in no event, can a *cestui que trust* be holden for an assessment under the statutes relating to national banks. Certainly, there is no express trust here, and we perceive no elements raising an implied trust. *The registered owners of the shares had completed their duty with reference to it;* they were under no obligation to see to the proper entries of the transfers on the books of the association; and the parties are, in every sense of the word, at 'quits', with no existing obligations or confidential relations between them, so far as this stock is concerned. Moreover, *if we were compelled to consider the proposition, we should probably hold that the statute, so far as it relates to the status of stock held in trust, concerns only express and active trusts,* where there is a probability of some estate to respond to the liability, and also that it does not apply when the records of the corporation show an unincumbered title in the alleged trustee, as is the fact at bar."

In the instant case, *no trust relationship was ever established.* There was no controversy between EDITH

LEVINSON, the *transferee,* and the petitioner, the *transferor.* The proof shows that plaintiff transferred his stock to EDITH LEVINSON. She filed no defense on the theory that there was any trust relationship between them, and *the plaintiff was not a creditor of the defendant when the transfer was made.*

In *Riley* v. *Bondi,* 64 Fed. (2d) 515, the Court cited (p. 519) the decision in *Lucas* v. *Coe,* 86 Fed. 972, on the point that the liability cannot be founded under a trust doctrine, *where there was no express or active trust,* but simply an implied trust, *and the law of agency was applicable.* The same rule was announced in *Larent* v. *Andersen,* 70 F. (2) 819, 824, C. C. A. 6. See also *Corker* v. *Soper,* 53 F. (2) 190, 191; *Barbour* v. *Thomas,* 7 F. S. 271, 277. A reference to these cases will show that the liability of a beneficiary of bank stock is *universally founded on the doctrine of undisclosed agency* and not on any trust relationship.

The question of whether a judgment on the superadded statutory liability may be taken against both the record owner and the real owner under the National Banking Act was discussed in *Continental Bank & Trust Company* v. *O'Neil,* 82 Fed. (2d) 650. There, Mr. Justice Evans justified the action against the beneficial owner on the theory that under the National Banking Act, there are *two* liabilities imposed, one, the liability of the record owner under Section 64, and two, the liability of the real owner under Section 66. The opinion states:

> "The two suits were allegedly upon different causes of actions. The instant suit was based upon a trustee's liability under 13 U. S. C. A. §66."

The decision in the *Continental Bank* case cited many decisions (pp. 653-654) on the point that there can be

no joint judgment. One of the cases cited therein, *Yardley* v. *Wilgus,* 56 Fed. 965, squarely holds to the *contrary.*

We quote the following from the marginal note in the *Continental* case, *supra*:

> "In *Yardley* v. *Wilgus,* 56 F. 965, 966 (C. C. 1893) W. was registered on the books as owner, but it was stipulated that he was merely trustee for S., the actual owner against whom a judgment had been recovered but was unsatisfied. The court said, 'Either Wilgus or Shellenberger could be held for this assessment, but not both * * * They cannot both be owners. * * * The statute * * * attaches the liability only to "shareholders". Upon proof that Wilgus * * * appeared upon the books * * * as a shareholder, he would be precluded * * * from asserting that he was not * * * a shareholder. * * * (But) in a suit against Shellenberger upon proof that he was the actual owner, it would not avail him to show that the stock stood in the name of another. But * * * it is admitted * * * Wilgus is not a shareholder, and * * * it has been judicially determined * * * that Shellenberger is the real owner. Both by this admission and adjudication we have, therefore, the fact conclusively established that Wilgus is not a shareholder * * * and it follows that he is not * * * liable for the assessment * * * .' "

(3) No Trust Relationship Was Established in the Instant Case.

There was no proof showing any trust relationship between the defendant and EDITH LEVINSON. The record merely shows that the defendant transferred a portion of his shares to her. *This transfer was made before the plaintiff became a creditor and while the bank was a going concern.* The defendant had the right to make a *gift* of the stock to EDITH LEVINSON for the express purpose of ter-

minating his liability. This was squarely held in *Sykes* v. *Holloway,* 81 Fed. 432. There, the Court held that a transfer of stock *although without consideration and to an irresponsible party,* cannot be set aside in the absence of fraud. No contention was made in the instant case that any fraud was practiced on the plaintiff. In fact, *the plaintiff extended the credit subsequent to the transfer.* The record owner did not defend the suit on the theory that she was a Trustee. The plaintiff had the burden to establish fraud or bad faith, (*Hodges* v. *Meriwether,* 55 Fed. (2) 29), which it completely failed.

We have, therefore, conclusively demonstrated that the instant case is based on a misconception of the law and is in conflict with the settled law in other Circuits.

II.

The Seventh Circuit Failed to Follow the Applicable Illinois Law Involving the Liability Under the Illinois Constitution.

The Illinois law is clear on the point that the liability of an undisclosed principal is not joint and several with his agent but is *alternative* and that a judgment against one operates as a release of the other. The Maryland Supreme Court, which reached the conclusion that the liability of an undisclosed bank stockholder is founded on the principle of agency and that such liability is alternative and that a judgment against one discharged the liability against the other, *cited Illinois decisions in support of its conclusion* consisting of the following: *Mussenden* v. *Raiffe,* 131 Ill. 456; *Limousine & Carriage Manufacturing Co.* v. *Shadburne,* 185 Ill. App. 403. In the *Mussenden* case, *supra,* there the court said:

> "In *Mattlage* v. *Poole*, 15 Hun. 556, which appears to have been a well-considered case, the complaint was against both principal and agent, and was dismissed as against the agent. Poole was the agent and O'Donoghue the principal. The court says: 'The question then is, whether it appears he made a binding selection of the principal, O'Donoghue, as his debtor. *Had he proceeded to judgment against the latter on the claim, he would be held concluded by his election.* (*Curtis* v. *Williamson*, 11 Eng. Rep. Moak's Notes 149, and *Priestly* v. *Ferrie*, there cited.) But will a proceeding at law on the claim, short of judgment, be conclusive of election? This question was considered in the case last cited, and it was there decided that *whilst a judgment against principal or agent, even without satisfaction, would constitute a conclusive election*, yet that no legal proceeding short of judgment would have that effect,' and the court held that no judgment having been entered against O'Donoghue, the principal, the action against Poole, the agent, was not barred."

In the *Limousine* case (185 Ill. App. 403, *supra*), the court said:

> "It cannot be doubted that where an agent without disclosing his principal enters into a contract he is personally liable thereon. So also is his principal. *But there is no joint liability on the agent and the principal. Kadish* v. *Bullen*, 10 Ill. App. 566. If the principal is discovered, he with whom such a contract is made must elect whether he will proceed against the agent or the principal." (Italics ours.)

It is apparent from the foregoing that *the Illinois law holds* that there can *only be one judgment.* In 118 A. L. R. 682, 701, the author quotes from 2 Amer. Jur. page 314, section 402, the following:

> "It is settled that after a disclosure of the relation of agency, a creditor or claimant may, at his option, hold either the agent or his undisclosed principal liable. As an instance, if a person sells goods, believing he is dealing with a principal, but finds the person is but an agent for a third party, he may recover the purchase money from either the principal or the agent. The agent is liable because credit was originally extended to him in the belief that he was acting for himself; the undisclosed principal is liable on the theory that, having authorized the agent to act or having received the benefits of the contract, he should be responsible for the agent's act and should assume the burdens arising therefrom. This liability is an *alternative* liability, *rather than a joint liability or a joint and several liability;* either the agent or his principal may be held, *but not both.* The weight of authority also holds that *after the disclosure of the agency* and the identity of the principal, it becomes the duty of the creditor or claimant *to elect, within a reasonable* time, which of the two he will look to to carry out the agreement of the agent. This election, when deemed made, is *irrevocable*, and does not depend upon the satisfaction of the claim."

In the instant case, the plaintiff *discovered on December 13, 1938, that the defendant was the undisclosed principal.* By the retention of the judgment and the delay up to April 9, 1940, *the plaintiff elected to keep the agent liable and released the principal.* Even in the Amended Complaint it did not allege that it was releasing the judgment against EDITH LEVINSON. *It retained the judgment and asked for another judgment.* This it could not do under the settled law. In 118 A. L. R. 704, the author says:

> "It has been generally held that where the agent and undisclosed principal are joined, the plaintiff may not have judgment against both, but *must, prior to judgment, elect to hold one or the other.*"

The author cites many authorities *including Illinois.* Under these decisions, respondent had no right to retain the judgment against EDITH LEVINSON and to claim another judgment against the petitioner. In line with these decisions is the decision of the Seventh Circuit in *Bowell* v. *Newberry,* 127 Fed. 656. There, Mr. Justice Baker in speaking for this court, said:

> "The decisions * * * and expressions in some other cases, to the effect that one who sells to the agent of an undisclosed principal may, on discovery of the principal, pursue either or both until he has obtained satisfaction, *do not meet our approval,*"

and to the same effect is the case of *Johnson* v. *Charles A. Garrigues,* 30 F. (2) 251-254 C. C. A. 2, and the Illinois decision above referred to.

In *Chicago Title & Trust Co.* v. *De La Soux,* 336 Ill. 552, it was said (p. 526):

> "The doctrine of election is based upon the assumption that two or more inconsistent and *alternative remedies* exist, and when a party selects one of these remedies he is precluded from prosecuting any other."

In *Scanlan* v. *Keith,* 102 Ill. 634, the court said:

> "The payee having elected to treat it as the note of the corporation, made through the instrumentality of its officers, by obtaining a judgment against the corporation, it would seem he ought not to be allowed or permitted to obtain another judgment on it against the officers, who were the mere agents acting on behalf of the corporation, as upon a personal undertaking by them. Having obtained a judgment against the corporation on the note, he ought to be concluded by his election, and be forever thereafter estopped to assert it was the in-

> dividual note of the officers executing it on behalf of the corporation. A case analogous in principle is maintained with great force of reasoning in *Melledge* v. *The Boston Iron Company,* 5 Cush. 158."

Even if it be said that respondent had the right to sue the agent and to obtain a judgment before it discovered the principal, and to thereafter sue the principal, it was necessary that the judgment against the agent be vacated before another judgment could be procured and respondent had to act with *due diligence.* The delay from 1938 to 1940 could not be due diligence, particularly when it was *not alleged that the judgment was not satisfied.*

In *Sluka* v. *Bielicki,* 335 Ill. 202 (page 210), it was said:

> "Where the doctrine of election of remedies applies *the bar arises as soon as the choice is made,* and becomes full and absolute against the other remedy at the time of the filing of the petition, declaration or claim. (*Bradner Smith & Co.* v. *Williams,* 178 Ill. 420.) This has been the rule in this State since *Herrington* v. *Hubbard,* 1 Scam. 569."

Much ado was made of the fact that respondent had his attorneys represent EDITH LEVINSON, his agent. There was no fraud perpetrated upon the plaintiff. The defendant transferred his stock to EDITH LEVINSON *before the plaintiff became a creditor of the bank* and plaintiff did not extend its credit because of anything that the defendant did. EDITH LEVINSON did not complain, and the relationship between her and the defendant is of no concern to the plaintiff. The fact that the defendant sent EDITH LEVINSON to his attorneys and paid for the cost of litigation against her does not in any way affect the rights involved herein. (*Madigan Bros.* v. *Garfield State Bank,* 310 Ill. App. p. 358.) The

defendant had the right to pay the expenses of his agent and there is nothing in law which prohibits a principal from having an agent to carry certain stock in his name. It is true that if a creditor is misled, he may have an action against the principal, but this is not the case here.

III.

The Seventh Circuit Failed to Follow the Illinois Law on the Point That a Bank Stockholder May Relieve Himself From Liability to Subsequent Creditors By a Gift Or Transfer of His Stock to a Registered Owner.

We have shown above that this was not a case of an undisclosed stockholder. Petitioner *was a registered owner who transferred his stock to another registered owner.* He had a right to transfer his stock even without consideration and as a gift to the transferee in order to escape and avoid liability as to future creditors.

In *Willson* v. *Labhart,* 269 Ill. App. 93, it was held that *the mere transfer of stock terminated the stockholders' liability for any credit extended subsequent to the transfer,* in the absence of proof that the transfer was fraudulent.

In *Bombal* v. *Peoples State Bank,* 367 Ill. 113, at page 117, the Court said:

> "The term 'stockholder' is defined frequently by the several States in their corporation acts. Its meaning varies according to the circumstances in which it is employed. A comprehensive definition is 'one who is a holder or proprietor of stock or stocks.' (Webster's New Internat. Dict., 2d ed.) Even though as between her and her husband there

was an understanding that the transfer of her bank stock was temporary, only, and the same stock was later to be returned to her, *nevertheless, by assigning the certificate therefor and causing a new certificate to be issued to him, which was later recorded, the defendant vested in her husband, so far as the creditors of the bank were concerned, the full title and ownership to the particular six three-hundredths part of the capital stock of the bank represented by her first stock certificate.* This stock thereafter remained in and was in him at the time the bank ceased operation. *She ceased to be a stockholder in the bank at the time she put the title to her stock in her husband,* but her responsibility remained, as fixed by section 6 of article 11 of the constitution, and as construed by this court, as a stockholder for the undischarged liabilities incurred during the period of her ownership of such *latter stock.*" (Emphasis ours.)

It was the duty of the Court to follow such law and to hold that petitioner was not liable after the transfer of his stock to the respondent who became a subsequent creditor and did not rely on the credit of the petitioner.

IV.

The Allowance of Interest on the Stockholders' Superadded Liability Is Not in Accordance With the Illinois Law and It Was the Duty of the Court to Follow the Illinois Law and to Disallow the Interest.

No demand was ever made upon petitioner to pay his superadded liability on the twenty-four shares. He was joined as a defendant for an alleged liability, and he satisfied such liability. He was later again brought into the case on April 9, 1940. The Court allowed interest from May 1, 1937, on the theory that his liabil-

ity was the same liability as that of the record owner against whom the judgment was entered on May 1, 1937. In the most recent case on the question of the liability for interest presented to the Illinois Supreme Court, *Lewis* v. *West Side Trust and Savings Bank*, 376 Ill. 11, the Court said:

> "Plaintiffs urge that the final stockholders should have been held liable, in equity, for interest from the date suit was filed, and that former stockholders likewise should have been liable for interest from the date the audit by Silver was furnished to them November 22, 1935. A great many pages are consumed in the 'pot calling the kettle black'—that is, in plaintiffs criticizing defendants and defendants pointing out wherein plaintiffs consumed time and unduly increased the size of the record. The plaintiffs do not rely on a statute to support their contention that interest should have been added to the amounts found due from stockholders. They agree with the rule that equity will allow interest in a proper case although not within the precise terms of the statute. (*Duncan* v. *Dazey*, 318 Ill. 500, 527, *Thompson* v. *Davis*, 297 *id.* 11; *Golden* v. *Cervenka*, *supra*, at page 409.) In chancery, interest is allowed where its allowance is warranted by equitable considerations. If it does not comport with justice, interest will not be allowed. (*McKay* v. *McCoid*, 298 Ill. 566, 572.) The principal claim of plaintiffs is that defendants were guilty of vexatious delay. The mere facts of appearing and defending a suit is not considered such delay. (*Imperial Hotel Co.* v. *Claflin Co.*, 175 Ill. 119.) There is no claim of fraud in this case as a reason for the allowance of interest but plaintiffs say that final stockholders knew at all times that the liabilities which accrued during their ownership far outran the par value of their stock and, therefore, they should have paid when sued."

The Court further said:

> "In *Munger* v. *Jacobson*, 99 Ill. 349, this court held interest was not recoverable against a stockholder in an action under Section 3 of the charter of the Bank of Chicago to recover a superadded liability in favor of creditors of that bank. The case did not involve the construction of the 1870 constitution but it is in line with the general policy of the courts of this State not to allow interest except where there is a statutory provision for it or justice and equity in a chancery suit, require its allowance. This contention of the plaintiffs is overruled."

For the foregoing reasons we urge the allowance of the writ.

Respectfully submitted,
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